

Stock Index Futures Hedging in the Emerging Malaysian Market

Professor Sunil Poshakwale

Andrew Kirchner

Welcome to the Talking Paper Series. I am Andrew Kirchner, and today I am joined by Professor Sunil Poshakwale. We are talking about his paper 'Stock Index Futures Hedging in the Emerging Malaysian Market'. It has been published in the *Global Finance Journal*, Volume 20, Number 3, 2009.

So, Sunil, to our listener, can you first of all explain what is meant by stock index futures?

Sunil Poshakwale

Well, very simply, stock index futures means buying a slice of the stock market. So just as you can buy and sell one share of British Telecom shares, you can buy and sell one share of the stock index. What, of course, stock index futures allow you to do is to go long and short. In other words, adjust your position depending upon what your expectation is, where the market is going to go. And it allows you to hedge your risk against your positions.

Andrew Kirchner

Sunil, why did you choose to focus on Malaysia? Reading your paper, I could see that the paper covered the period of the Asian financial crisis of the late 90s.

Sunil Poshakwale

Yes, the Malaysian market provides us with excellent context because Malaysia has gone through the major Asian financial crisis as you just said in 97/98, but more significantly, after that Malaysia also imposed what we call the capital control regulations which stock the foreign institutional investors from withdrawing large amounts of profits back to their home countries because the Malaysian government felt that this was causing excessive volatility in the market.

Also, the Malaysian market introduced the stock index futures since 1995 and we were fortunate to have data on it right from the inception to 2001. So it provided us with an excellent case where we could try and test the well established econometric models and see whether or not they work in the Malaysian context.

Andrew Kirchner

So what did you find in your research?

Sunil Poshakwale

In our research what we have found is that the established econometric models used to calculate the number of contracts you require to hedge your portfolio risk do work in the Malaysian context as well, but if we try and adjust the performance evaluation criteria, we find that maybe the performance of the well established models are not as good as they are claimed to be in other developed markets where these models have been tested traditionally.

Secondly, we find that the GARCH models – which are called generalised conditional heteroskedasticity models – are able to capture the volatility characteristics of the Malaysian market because one would have thought that with the happening of the financial crisis in 97/98 and then subsequently the capital controls that were imposed by the government authorities in Malaysia, the volatility of the Malaysian market would change. But we do find that far as models are concerned we do not observe any significant change in the volatility characteristics; in other words, the models seem to capture the volatility very well.

Andrew Kirchner So it can be taken across the board in other emerging markets?

Sunil Poshakwale Correct. We believe that our paper makes an important contribution because it sort of tests the models in an emerging market context – something that has not been extensively done – and our findings would, we believe, be equally applicable to other emerging markets in Asia.

Andrew Kirchner So that is the key finding?

Sunil Poshakwale Yes

Andrew Kirchner Sunil, thank you very much indeed.
